

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION

In the Matter of the Application of
Northwestern Bell Telephone Company,
Minneapolis, Minnesota for Authority
to Change its Schedule of Telephone
Rates for Customers Within the State
of Minnesota.

REPORT OF THE
ADMINISTRATIVE LAW JODIE
PART I

The above-captioned matter came on for hearing before Bruce D. Campbell,
an Administrative Law Judge for the office of Administrative hearings on
January 9, 1984. additional evidentiary hearings were held on January 10-13,
16-20, 23-27 and 30; March 12-16, 19-23, 26 and 27; and April 5, 1984.

Public hearings for the purpose of receiving the comments and
questions of
affected ratepayers were held as follows:

January 23	St. Paul - 1:00 and 7:00 p.m.
January 24	Winona - 7:00 p.m.
January 25	Owatonna - 7:30 p.m.
January 26	Marshall - 7:00 p.m.
January 27	Willmar - 7:00 p.m.
February 7	Duluth - 7:00 p.m.
February 8	Virginia - 7:00 p.m.
February 9	Crookston - 7:00 p.m.
February 10	Moorhead - 7:00 p.m.
February 21	Faribault - 7:30 p.m.
February 22	Minneapolis - 1:00 and 7:30 p.m.
February 23	Cambridge - 7:00 p.m.
February 24	Little Falls - 7:00 p.m.

During the public hearings, the public participated as follows: St. Paul -
1:00 P.M. - 150 people attended and 12 people spoke; St. Paul - 7:00
p.m. - 15
people attended and 13 spoke; Winona - 35 people attended and 18 people
spoke;
Owatonna - 27 people appeared and 8 people spoke; Marshall - 30 people
appeared and 11 people spoke; Willmar - 2 people appeared and 2 people spoke;
Duluth -- 7:00 p.m. . -- 40 people appeared and 6 people spoke; Virginia -
30
people appeared and 6 people spoke; Crookston - 4 people appeared and
3 people
spoke; Moorhead - 3 people appeared and 1 person spoke; Faribault - 140
people
appeared and 12 people spoke; Minneapolis - 1:00 p.m. - 500 people appeared
12 people spoke, Minneapolis - 7:30 p.m. - 30 people appeared and 12

140. As a consequence of Findings 131-139, supra, the CWC allowance for inclusion in the Company's test year rate base is a negative \$7,966,00.

Discussion

The Department of Public Service reiterates a position that has been squarely rejected by the Commission in prior decisions involving Northwestern Bell. There is no evidence in the record that would justify the administrative Law Judge in departing from the prior determinations of the Commission that the isolated inclusion in the calculation of a cash working capital requirement of isolated capital or investor transactions without including all such transactions is inappropriate. Moreover, the weight of administrative and judicial decisions with respect to the issue support the position taken by the Company. See, Initial Brief of Northwestern Bell Telephone Company, Vol. II, pp 80-82. moreover, even if the theoretical adjustment suggested by the chief financial witness for the Department were to be accepted, in principal, his calculation of the amount of such adjustment would, itself, render acceptance of the adjustment inappropriate. See, Initial Brief of Northwestern Bell Telephone Company, Vol. II, pp, 87-91.

Since the calculation of a cash working capital requirement reflects the totality of the changes to the Company's submission contained in these Findings and, ultimately, in the Final Order of the Commission, the Administrative Law Judge has not recalculated a cash working capital requirement reflecting his Findings. Doing so was impossible within the time constraints imposed and the Company's method of calculating its CWC requirement. As noted in the Findings, the Commission, in issuing its Final Order, should recalculate the cash working capital requirement to incorporate its final determinations. The Administrative Law Judge has used the recommendation of DPS for CWC, even though it includes a highly inappropriate factor, only because it understates the rate base to a lesser degree than the Company's result, which was premised upon its revised filing.

As also reflected in the Findings, the Company's initial calculation did not include a state income tax payment lag factor. The Company agrees that the inclusion in the final determination of the cash working capital requirement of an appropriate lag factor relating to the payment of state income taxes is appropriate. The Administrative Law Judge accepts the testimony of the Company with respect to the state income tax lag factor as being the appropriate method of determining the calculation, as opposed to that of the Department. The appropriate lag factor for the payment of state income taxes, using the midpoint of the year, July 2, is 83.40 days adjusted by three days to recognize the average draft lag involved, or, 86.40 days.

Directory operations

141. On January 1, 1984, Northwestern Bell transferred its directory operations, both white and yellow pages, to Landmark Publishing, an affiliate of NWB's ultimate parent, U.S. West. Landmark's subsidiary, U.S. West Direct, is currently carrying out the directory activities which prior to divestiture were performed by NWB.

142. In its original rate filing made with the Commission in September of 1983, the Company did not include any testimony reflecting its anticipated disposition of directory operations. The transfer of directory activities became known in this proceeding after its occurrence was disclosed during the initial hearings herein after the transaction had been completed. All rate base revenues and expense data regarding directory operations is currently included in the Company's filing as though such operations had not been transfer red.

143. Corporate discussions concerning the transfer of directory activities from Northwestern Bell began sometime in the last half of 1982. Tr. 45, p. 10, p. 11. The contract negotiations to effectuate that transfer began sometime in the summer and fall of 1983. Tr. 45, p. 12.

144. On December 30, 1983, Northwestern Bell advised the Commission, by letter, of the transfer of its directory activities and advised the Commission that a transfer of \$25,430,000 in liquid assets had been accomplished.

145. On January 23, 1984, several Intervenors requested the Commission to investigate the transfer and to advise Northwestern Bell that the Commission might disallow the transfer.

146. On February 7, 1984, the Commission ordered the investigation to be conducted through this rate proceeding and suggested that parties address the issue of the Commission's jurisdiction to disallow the transfer in their responsive briefs to the Administrative Law Judge.

147. Northwestern Bell and U.S. West Direct have entered into a two-year contract, as a consequence of which Northwestern Bell will receive transition and publishing fees as follows:

1984, Publishing Fee - \$19,000,000, Transition Fee - \$9,000,000

1985, Publishing Fee - \$45,100,000, Transition Fee - \$4,000,000

1986, Publishing Fee - \$47,300,000, Transition Fee - -0-

NWB Ex. 239, p. 9.

148. The total agreement between Northwestern Bell and U.S. West Direct for directory publication is embodied in eight contracts. NWB Ex. 239-250. The principle agreement between the parties is the Publishing Agreement which reflects the payments to Northwestern Bell previously discussed.

149. In addition to the payment of the fees previously mentioned, the

agreement may be extended for an additional two years from December 31, 1986, by Northwestern Bell upon six-month's notice to U.S. West Direct. However, any fees to be received by Northwestern Bell subsequent to December 31, 1986, would be subject to negotiation between Northwestern Bell and U.S. West Direct.

150. Either party may cancel the Publishing Agreement by providing one year's written notice to the other party. NWB Ex. 239, p. 2.

151. A number of provisions of the Publishing Agreement retain in Northwestern Bell a measure of control over the directory services to be provided by U.S. West Direct to ratepayers of Northwestern Bell in the publication and provision of telephone directories. See, initial Brief of Northwestern Bell Telephone Company, vol. II, pp. 305-308.

152. The Company, in its rebuttal testimony, stated that the information available to it was not sufficiently reliable for rate-making purposes to reflect changes in the 1983 test year data, except to reduce the requested rate of return by five basis points. NWB Ex. 270, pp. 25-27.

153. For rate-making purposes, the Company bears the burden of proof that all of its contracts having an impact on the revenue requirement are reasonable. Minn. Stat. 237.075, subd. 4 (1983 supp.). Especially with respect to affiliate transactions, the Company must demonstrate that the contract is as favorable as could have been obtained in true arms-length transactions, insofar as the transaction affects the Company's revenue requirement.

154. Northwestern Bell has not provided for the record competent evidence as to the effect of the affiliate transaction on the revenue requirement during the period for which rates are likely to remain in effect.

155. A telephone company seeking a rate increase under Minn. Stat. Ch. 237 (1983 Supp.), has a duty to provide to the Commission evidence from which it can be determined whether an adjustment to test year revenues is appropriate.

156. There is substantial evidence in the record from which it can be determined that the imputation of revenue to the Company as a consequence of the affiliated transactions is appropriate.

157. The specificity with which the amount of revenue to be attributed can be determined is limited by the Company's failure to maintain appropriate data from which the precise revenue impact can be determined.

158. It is appropriate and within the jurisdiction of the Commission to require the Company and its affiliate to maintain records from which the precise effects of the transfer of assets and affiliated transactions can be determined for subsequent rate-making proceedings.

159. The Commission has no statutory authority with respect to the negation of affiliated transactions of a telephone company similar to that exercised with respect to public utilities, as defined in Minn. Stat. sec. 216B.02, subd. 4 (1983), as reflected in Minn. Stat. sec. 216B.48 (1983 supp.).

160. The transfer of assets by the Company to an affiliated subsidiary of its corporate parent did not require the prior approval of the Commission pursuant to Minn. Stat. 237.23 (1983 Supp.).

161. As a consequence Of Finding 142, supra, no adjustment to test year rate base is appropriate.

162. As a consequence of Findings 141-161, supra, it is appropriate to increase net test year pre-tax income by \$2,526,666. Reply Brief of Northwestern Bell Telephone Company, pp. 177-178.

Discussion

The subject of the transfer of assets and the consummation of contracts with an affiliate regarding directory publication is typical of several other issues that the Company has introduced into this rate filing at a late date. Although corporate discussions concerning a transfer of directory publications from NWB began some time in the last half of 1982, the Commission was not notified of NWB's intentions until December 30, 1983. The Company was allowed to inject into its rebuttal testimony its justification for the transactions with the ultimate burden of proof that the transactions, even though with an affiliate, would not adversely impact ratepayers or require a pro forma adjustment to the test year revenue deficiency as a consequence of lost revenues.

The Company strenuously argues that the contract payments provided for in the Publishing Agreement provide a sufficient proxy for the revenue contributions formerly received from directory advertising. However, the testimony of the Company with respect to its care in the consummation of the contract leaves much to be desired. Neither Northwestern Bell or U.S. West investigated the possibility of contracting for directory advertising services from an independent provider. AG Ex. 253. The Minutes of the NWB Board meeting at which the transfer to U.S. West Direct was approved indicate that little corporate choice was offered NWB. AG Ex. 245. Moreover, there is no evidence in the record regarding the method by which the amounts of the contract payments were determined. Tr. 45, pp. 14-15. The chief executive officer of the Northwestern Bell could not state with any degree of certainty, what Minnesota's share of payments would be in the future, Tr. 45, p. 15, or even that the payments made to NWB would be credited to the benefit of the ratepayers, Tr. 45, pp. 16-17.

The Company cites a plethora of business reasons supporting the transfer. In its judgment, Northwestern Bell Telephone Company, in consideration of guaranteed payments, is relieved of a variety of risks and responsibilities while the anti-trust concerns of the Company are lessened. For the reasons discussed in the briefs of intervenors, the Administrative Law Judge concludes that the substantial business reasons offered by Northwestern Bell Telephone Company for the transfer are, in effect, justifications for a decision made at a corporate level other than Northwestern Bell for profit motives. if, for example, the risks to U.S. Direct of the contract should prove to have a negative result, it can cancel the contract upon six month's notice to NWB. With the cancellation provision, there is little, if any, assumption of risk by U.S. West Direct. It cannot be suggested that yellow page advertising has been anything other than a profitable adjunct to the provision of telephone service. Northwestern Bell ratepayers should not be deprived of such benefits thought the rearrangement of corporate structures.

Under somewhat similar circumstances, the Administrative Law judge recommended dismissal of this entire proceeding on the ground that the Company had not provided evidence from which the Commission could make a reasoned judgment as to whether the rates proposed by Northwestern Bell were appropriate. Many of the same circumstances and arguments made with respect

that Recommendation apply equally to the instant case. The Commission, however, has determined that immediate dismissal, under the circumstances of the corporate restructuring, was an inappropriate remedy. In the instant case, at least, the company did offer some testimony regarding its divestiture of directory functions. It concluded, however, that the evidence did not justify any alteration to test year data to account for the rate-making effects of the transfer, except a minor adjustment to capital structure. The Company's inability to provide substantive information may not be calculated on its part. However, if the Commission is to set rates it must have information from which it can make reasoned judgments. The Company may not plead ignorance, for whatever reason, when there may be a reduction in its revenue requirement, characterize the lack of substantive evidence as not amounting to a "known and measurable change", and finally shift the burdens to Intervenor to provide information which the Company is obligated to provide as a consequence of its burden of proof. Minn. Stat. S 237.075, subd. 4 (1983 supp.).

Intervenor argues earnestly that the Commission has statutory authority to void the transactions for the failure of the Company to obtain prior Commission approval. Minn. Stat. 237.23 (1983 Supp.). That statute, however, when fairly read, relates to the transfer of the assets of one regulated telephone company to a second regulated telephone company. The provision of the statute relied upon by the Intervenor refers back to the sale between telephone companies discussed in the first paragraph of the statute. There is no real suggestion that U.S. West Direct is, itself, a telephone company subject to regulation under Minn. Stat. Ch. 237 (1983 Supp.). The construction of the statute suggested by Intervenor would require prior Commission approval of the sale by a regulated telephone company of any asset contained in its rate base to a private party. That such was not the intent of the statute, with the continued involvement of the Commission, appears clear.

The Administrative law Judge shares the disquiet of the Intervenor about Northwestern Bell's motives for engaging in the transaction and its effect on ratepayers. Be can, however, find no authority in Minn. Stat. Ch. 237 (1983 Supp.), to require prior Commission approval of the transfer.

It is clear that the effects of yellow page advertising and directory publication are to be included in the calculation of a Company's revenue

deficiency. This Commission has so determined and the precedent cited by Intervenor so holds. State v. Southern Bell Telephone & Telegraph Co., 921 S.B.2d 789 (N.C.App. 1982); Serpa, v. Pacific Telephone & Telegraph Co., 17 P.U.R.3d 378 (Cal. P.U.C. 1957); United Telephone Co., P-430/GR-82-200; United Telephone Co., No. 125, 298-U, pp. 9-10, Kansas, May 2, 1981.

The Commission, however, has not historically been concerned with the manner in which directories are published, whether by the Company itself or on

a contract basis. Indeed, the bulk of authority, as cited by the Company, has determined that the provision of yellow page advertising is not a public utility function and is subject to only minor direct Commission regulation. The concerns of the Intervenors arise because this is an affiliated transaction, the reasonableness of which has not been demonstrated on the record. The Minnesota legislature has not seen fit to include within Minn. stat. Ch. 237 (1983 Supp.), a detailed provision regarding prior approval of affiliate transactions similar to that contained in Minn. Stat. 216B.48 (1983 Supp.). No amount of suspicion of the Company's motives and concern about the state of the record regarding the reasonableness of the transaction obviates the limitations of the Commission's authority imposed by both the case law and statutory provisions. That does not, however, require a conclusion that the Commission is totally without authority or a remedy in this matter.

As noted in the Findings, especially with respect to affiliated transactions, the Company must demonstrate the reasonableness of its contracts. The Commission clearly has jurisdiction to reflect, in the determination of the Company's revenue deficiency, the appropriate effects of its affiliate contracts and to disallow expenses or impute revenue as appropriate to account for such contracts. In re New Bedford Gas & Edison Light Co., 30 P.U.R.3rd 510 (Vass. PUC 1959); In re United Telegraph Co. of Missouri, Case Note, TR-80-235, Feb. 13, 1981; in re General Telegraph Co. of Upstate New York, 41 P.U.R.3d I (N.Y. Comm. 1961); Montana-Dakota Utilities Co. of Minneapolis, Minnesota, 33 P.U.R.3d 631, 102 N.W.2d 329 (N.D. 1960).

Such historically has been the test applied by the Commission with respect to affiliated transactions. For example, the Company has never suggested that its former relationship with Western Electric was not subject to review by the Commission as to the reasonableness of prices paid and subject to a reflection of that determination in its rate proceeding. If the Commission has the authority to reflect in a rate-making proceeding the likely effects of affiliate transactions, with respect to their reasonableness, it has the right to require the Company to provide it with the information from which that determination can be made. The Commission has broad regulatory authority to require the Company and its unregulated subsidiary to maintain the records appropriate to determine the rate-making effect to be given affiliated transactions. In re Rochester Telephone Corp., 41 P.U.R.4th 331 (N.Y. PUC. 1980).

The Administrative Law Judge does not have the expertise to direct the

Commission or the Company as to what records would be appropriate. suffice it to say that, in future rate-making proceedings, the reasonableness of this affiliate transaction ought not to be tested by the Company's current state of ignorance of the facts. It must keep those records that are necessary to enable the Commission to make a proper rate-making determination in subsequent cases. It would be appropriate for the Commission to direct the Company as to the appropriate records to be maintained so that the effect of these affiliated transactions can be determined for rate-making purposes.

it would be preferable if the Legislature amended Minn. Stat. 216B.48 (1983 Supp.) to include telephone companies. The Administrative Law judge

urges the Commission to request such an amendment to the statute in the next session of the Legislature.

The Administrative Law Judge has recommended an adjustment to the net income of the Company as the most likely, verifiable, impact of the divestiture of directory operations during the time within which revised rates may remain in effect. As reflected in the record, several intervenors have made calculations of the short-term effect of the loss of yellow page advertising revenues to the Company and the substitution of "guaranteed payments". The most likely calculation, reflecting the average growth in profits from directory advertising, is that made by the Department of Public Service in its initial Brief regarding revenue deficiency. A much higher figure was approximated by the Office of the Attorney General. The Administrative Law Judge recognizes that there are deficiencies in both calculations which result from a lack of information provided by the Company. The Company asserts in its testimony that it cannot judge the impact of the divestiture of directory activities, but then criticizes reasonable approximations made by intervenors as a consequence of a lack of direct information from the Company. Since the Commission has determined that the failure of the Company to provide information regarding the likely effect of a transaction affecting rates does not justify dismissal, and since, in the opinion of the Administrative Law Judge, the law does not permit the undoing directly of the transactions, the maintenance of the appropriate records and the imputation of a conservative estimate of likely revenue impact, must serve as a proxy until affiliated transactions by telephone companies can be subject to direct Commission control. In determining the precise amount of the adjustment, the Administrative Law Judge has employed the recalculation of the amount previously suggested by the Department of Public Service contained in the Reply Brief of the Company.

163. Except as otherwise required by the previous Findings herein, no additional adjustments to the Company's test year rate base are appropriate.

164. As a consequence of Findings 60-163, supra, relative to rate base and the agreement of the parties regarding the remaining components of the rate base, the Company's end of period jurisdictional rate base for the test year is \$1,028,206,000, calculated as set forth in Exhibit B, attached hereto.

VII. OPERATING INCOME

Divestiture effects

165. As a consequence of Findings 40-59, supra, and Findings 61-64, supra, and the Discussion following such Findings, it is appropriate to apply to the Company's revenues and expenses divestiture ratios based on discreet data for all identified sub-accounts where such information is available rather than combined, aggregate percentages applied to major accounts.

